UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

COMMERCIAL LEGAL REFORM ASSESSMENTS FOR EUROPE AND EURASIA

Final
Diagnostic Assessment Report for Ukraine

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I. Overview

The Ukraine diagnostic provides the third component in a four country study that assesses the current commercial law environment in Central and Eastern Europe and the New Independent States (CEE/NIS). Each country included in this study was selected for its unique circumstances including location, geography, size, economic base, legal traditions, and relative progress in transition toward a market-oriented economy. Ukraine was selected for study for many reasons, not least of which include its size, geo-strategic position, and the difficulties it has experienced in making the transition to an open market economy.

Ukraine's experience in transition generally, and commercial law reform specifically, help set up some of the "big" questions that this study was intended to raise. For example, what role do historical chance and culture play in the evolution of commercial life, and the laws the rules that are developed to govern it? Is Ukraine truly a "unique variant" requiring uniquely Ukrainian solutions? What root causes explain the stark differences between Ukraine and Poland's experience in commercial law reform?

Certainly, these questions are not new. More than 160 years ago, Alexis De Tocqueville asked essentially the same questions about America—then a newly emergent democracy and commercial power. In searching for an explanation for America's success, he concluded that:

> "All the causes which contribute to the maintenance of a democratic republic in the United States are reducible to three heads:
>
> 1. The peculiar and accidental situation in which Providence has placed the Americans;
> 2. The laws; and,
> 3. The manners and customs of the people.
>
> These three great causes serve, no doubt to regulate and direct American democracy; but if they were to be classed in their proper order, I should say that physical circumstances are less efficient than the laws, and the laws infinitely less so than the customs of the people. I am convinced that the most advantageous situation and the best possible laws cannot maintain a constitution in spite of the customs of a country; while the latter may turn to some advantage the most unfavorable positions and the worst laws."[1]

The diagnostic team's findings support the widely held view that Ukraine's progress toward a market economy is not proceeding rapidly. Despite the multiplication of McDonald's restaurants, and upscale shops in Kiev, the environment for private commercial activity seems little changed since early 1994. In fact, the commercial environment in outlying oblasts and cities is reported to be eroding.

[1] Democracy in America, Vol. I, Ch. XVII, Alexis de Tocqueville

Digging at the roots of Ukraine's current lethargy in reforming its economy is a difficult undertaking. For those familiar with the country, its culture, and its history, there is something familiar in the widely held belief that the way forward for Ukraine is as unique and distinct as the problems that beset it. If De Tocqueville's observation that the "customs" of the people matter, what are the implications for Ukraine?

The diagnostic assessment that serves as the basis for this study was conducted in-country between March 3 - 17, 1999. Interviews and data collection were conducted by a team of three expatriate lawyers, supported by a Ukrainian law student and an interpreter. Given time constraints, data collection was limited to the Kiev area, however, interviews were conducted with individuals familiar with current conditions in various regions of Ukraine. The diagnostic methodology employed during this assessment was mirrored that of earlier assessments conducted in Poland and Romania.

Broad Indicator	Poland	Romania	Ukraine	Kazakhstan
Population (millions)	38.7	22.5	50.5	16.3
Area (km^2)	312,683	237,500	603,700	2,717,300
1997 GDP Per Capita[2]	$6,400	$5,200	$3,170	$2,880
Ave. Δ GDP (1990 – 1996)	3.2%	0.0%	-13.6%	-10.5%
% GDP – Government	18.5	10.1	22.0	12.3
% GDP – Industry	30.7	38.7	40.1	30.4
% GDP – Agriculture	5.1	22.8	12.3	12.9
% GDP – Services	64.2	38.5	47.7	56.8
FDI (Cum. 1989 - 98 in billions)	$20	$3.4	$2.0	
FDI (Cum. per capita)	$5,170	$1,510	$40	
Corruption Index[3]	4.6	3.0	2.8	--
Credibility Index[4]	68.05	52.96	>40	48.04
EBRD Legal Transition Index[5]	4/4	3/4	2/2	2/2
Moody's Emerging Mkt. Rating	Baa3	B3	B3	Ba3

[2] International Monetary Fund, stated in constant dollars.
[3] Transparency International 1998. Scale = 1 - 10. Higher scores indicate less corruption.
[4] *Euromoney Magazine*, December 1997. Scale = 1 - 100. Higher scores indicate greater credibility of government offerings and undertakings.
[5] European Bank for Reconstruction & Development, *1998 Transition Report*. Scale = 1 - 4+, where 4+ is most advanced. 1997 and 1998 figures are included. Of those countries included in the sample, only Romania's score changed between 1997 and 1998.

As indicated by the table of general economic indicators and perception indices above, Ukraine is lagging behind in the transition to a market economy. Per capita GDP is approximately half that of Poland, and only 10% larger than that of Kazakhstan, which in relative terms is significantly less industrialized than Ukraine. Of the sample group, Ukraine's economy has contracted substantially more than the others, and the state sector remains a significant (+20%) portion of the economy.

In general, the pace and content of economic reform in Ukraine lags behind many of the countries in the region. Privatization of small enterprises in Ukraine is complete. To date, shares in approximately 75% of the medium- and large-scale enterprises available for privatization have been transferred to private holders. Progress toward reducing the government's "negative list" of large-scale enterprises not included in the privatization program has been limited.

A significant constraint to doing business in Ukraine remains the relative lack of transparency, stability, and predictability in the legal and regulatory norms governing private sector activity. The results of the diagnostic assessment tend to support this general perception. Many of the problems encountered in Ukraine were found in both Poland and Romania. The chief differences among them in this respect seem to be largely in degree of magnitude and nuance. A more detailed comparative assessment of these findings will be provided in a Synthesis Report that will be prepared following the Kazakh diagnostic assessment.

II. Summary Indicator Results

The summary table on the next page contains the raw Tier I and Tier II indicator results. No attempt has been made to "balance" the four dimensions of this analysis, or give differential weighting to the subject matters areas. For a detailed discussion and analysis of the results, please consult the Tier III tables and associated narrative discussion for each subject matter area.

Based on the results of the in-country assessment, Ukraine ranks well behind both Poland and Romania in terms of overall development of the commercial environment. At 41% of the total possible score, Ukraine's legal and regulatory environment can be characterized as generally hostile to legitimate commercial activity. Bright spots for Ukraine in the first dimension of this analysis—the legal framework—include collateral law (76% of the total available points for scoring) and the Law on Foreign Direct Investment (89%). Ukraine's legal framework for international trade (56%) and bankruptcy (41%) were rated lowest in the assessment. Further explanation of the methodology and interpretation of these raw scores appears in subsequent sections of this report.

The institutional framework for implementation and enforcement of the laws and regulations within the seven subject matters areas was relatively weak across the spectrum for Ukraine. For implementing institutions, the areas of FDI (18%), bankruptcy (45%) and trade (34%) ranked lowest, while implementing institutions for collateral and company faired somewhat better (56%

and 52% respectively). A more detailed narrative analysis of these findings can be found in the subject-specific narrative descriptions that follow.

The third dimension of this assessment found the supporting institutions to be weakest in the areas of trade (19%) and FDI (28%), and strongest in contract law (50%). Given the well known difficulties of contract enforcement in Ukraine, this result may actually overstate the relevant importance of such supporting institutions as law firms, notaries, and bailiffs.

	SUBSTANTIVE AREA	Poland	Romania	Ukraine	Kazakhstan
A.	**BANKRUPTCY**	**78%**	**54%**	**37%**	
	1. Legal Framework	80%	59%	41%	
	2. Implementing Institutions	80%	62%	45%	
	3. Supporting Institutions	76%	52%	33%	
	4. Market for Effective Bankruptcy System	78%	45%	28%	
B.	**COLLATERAL**	**77%**	**32%**	**48%**	
	1. Legal Framework	90%	44%	76%	
	2. Implementing Institutions	79%	13%	56%	
	3. Supporting Institutions	65%	35%	31%	
	4. Market for A Modern Collateral System	75%	37%	30%	
C.	**COMPANY**	**79%**	**62%**	**44%**	
	1. Legal Framework	81%	63%	47%	
	2. Implementing Institutions	76%	73%	52%	
	3. Supporting Institutions	82%	70%	42%	
	4. Market for Efficient Company Law	78%	43%	33%	
D.	**COMPETITION**	**80%**	**60%**	**41%**	
	1. Legal Framework	82%	66%	55%	
	2. Implementing Institutions	81%	62%	42%	
	3. Supporting Institutions	81%	62%	42%	
	4. Market for Open, Competitive Economy	78%	49%	28%	
E.	**CONTRACT**	**80%**	**63%**	**45%**	
	1. Legal Framework	83%	74%	50%	
	2. Implementing Institutions	83%	73%	49%	
	3. Supporting Institutions	79%	66%	50%	
	4. Market for Efficient Contract Law	75%	37%	30%	
F.	**FDI**	**77%**	**57%**	**41%**	
	1. Legal Framework	87%	96%	89%	
	2. Implementing Institutions	82%	58%	18%	
	3. Supporting Institutions	66%	38%	28%	
	4. Market for Increased FDI	75%	37%	30%	
G.	**TRADE**	**68%**	**54%**	**33%**	
	1. Legal Framework	93%	90%	56%	
	2. Implementing Institutions	71%	53%	34%	
	3. Supporting Institutions	49%	40%	19%	
	4. Market for Trade Liberalization	61%	35%	21%	
AGGREGATE TOTALS for all areas of law		**77%**	**55%**	**41%**	

The "market" for commercial law reform in Ukraine is similarly weak across the seven subject matter areas and below both Poland and Romania. The relative imbalance in the "market" can be characterized by a relative oversupply of inadequate, incomplete, and often conflicting laws, regulations, and institutional arrangements, in response to a weak, and rather diffuse level of demand from the private sector.

III. Notes on Scope & Methodology

This diagnostic assessment was designed to help achieve the following objectives:

1. To provide a factual basis for characterizing the degree of development and the level of effectiveness of the commercial law reforms initiated in Ukraine since independence in August 1991;

2. To provide a methodologically consistent foundation for drawing cross-country comparisons in an effort to identify and describe the root causes of the "implementation/enforcement" gap; and,

3. To provide analytical and planning tools and metrics that will help USAID design new approaches to sustainable, cost-effective C-LIR interventions in the region and elsewhere.

For the purposes of this effort, "commercial law" is defined to include the following substantive legal areas:

- ***Bankruptcy*** - Mechanisms intended to facilitate orderly market exit, liquidation of outstanding financial claims on assets, and rehabilitation of insolvent debtors.

- ***Collateral*** - Laws, procedures, and institutions designed to facilitate commerce by promoting transparency, predictability, and simplicity in creating, identifying, and extinguishing security interests in assets.

- ***Company*** - Legal regime(s) for market entry and operation that define norms for organization of formal commercial activities conducted by two or more individuals.

- ***Competition*** - Rules, policies, and supporting institutions intended to help promote and protect open, fair, and economically efficient competition in the market, and for the market.

- ***Contract*** - The legal regime and institutional framework for the creation, interpretation, and enforcement of commercial obligations between one or more parties.

- ***Foreign Direct Investment*** - The laws, procedures, and institutions that regulate the treatment of foreign direct investment.

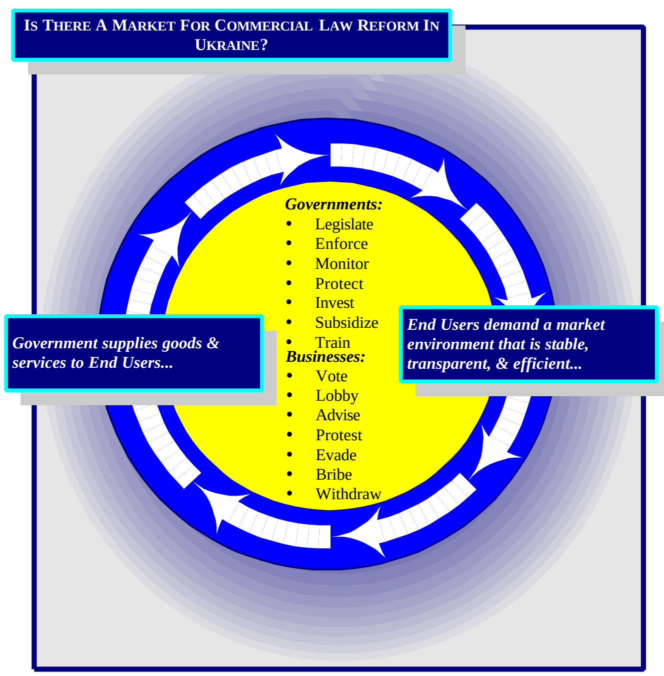
- ***Trade*** - The laws, procedures, and institutions governing cross-border sale of goods and services.

Each of these substantive areas has been assessed by collecting data across the four sample countries. Within each of these substantive areas, four "dimensions" of C-LIR are proposed as a conceptual framework for comparison. These include:

- Framework Law(s) - Basic legal documents that define and regulate the substantive rights, duties, and obligations of affected parties and provide the organizational mandate for implementing institutions (e.g., Law on Bankruptcy, Law on Pledge of Moveable Property);

- Implementing Institution(s) - Governmental, quasi-governmental or private institutions in which primary legal mandate to implement, administer, interpret, or enforce framework law(s) is vested (e.g., bankruptcy court, collateral registry);

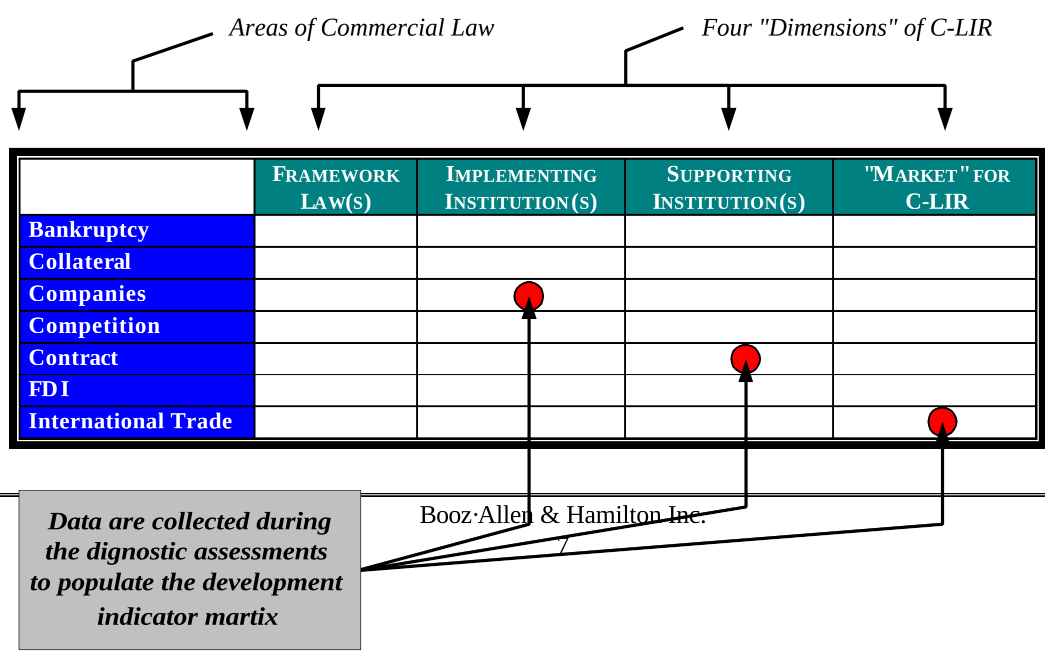
- Supporting Institution(s) - Governmental, quasi-governmental or private institutions that either support or facilitate the implementation, administration, interpretation, or enforcement of framework law(s) (e.g., bankruptcy trustees, notaries); and,



- "Market" For C-LIR - The interplay of stakeholder interests within a given society, jurisdiction, or group that, in aggregate, exert an influence over the substance, pace, or direction of commercial law reform.

Within each substantive area, development indicators have been defined for each of the four "dimensions" of C-LIR. The figure below provides a conceptual overview of how the development indicators are organized. The twenty-eight "cells" below represent groups of development indicators (or simple propositions) that are designed to provide a "snapshot" of the current state of commercial law reform in each subject area. From a practical standpoint, the diagnostic assessment itself is performed by collecting and analyzing data through published sources, and face-to-face interviews, that are used to populate the development indicator tables.

Conceptual Overview of C-LIR Development Indicators



IV. Interpretive Notes on Interpreting C-LIR Indicator Tables

Figures 1 and 2 below illustrate how the indicator tables are organized and can be interpreted. The first example presented is a summary table of "Tier I" and Tier II" indicators for collateral law. The four "dimensions" of commercial law development around which this analysis is organized appear in the left column of table. In this case, the table summarizes the collateral law. The next column to the right ("Ref.") contains a "reference value" (i.e., benchmark) against which the countries in this study will be compared. As indicated, the total score for Country A (228) and Country D (181) in the area of collateral law are to be compared against the reference value for this analysis (400). From this example, it might be inferred that Country A's collateral law system is more advanced than Country D's.

FIG. 1 - TIER I & II INDICATORS

COLLATERAL LAW	REF.	A	B	C	D
Legal Framework	100	85	90	22	64
Implementing Institution	100	72	25	33	47
Supporting Institution	100	34	67	35	49
"Market" for C-LIR	100	37	53	66	21
TOTAL	400	228	235	156	181

4 "Dimensions" of C-LIR

Country Totals = "Tier I" Indicators

Sub-Totals = "Tier II" Indicators

The Tier I and II indicators in Fig. 1 above are derived from the raw data collected in the course of the diagnostic assessments. Tier I indicators provide the highest level of abstraction[6] and are intended to be most useful to policy makers and those interested in broad regional comparisons of

FIG. 2 - TIER II & III INDICATORS

B.1.	LEGAL FRAMEWORK - COLLATERAL	REF.	A	B	C	D
1	Law recognizes personal guaranties, either direct or third party, and bank guaranties	10	2	1	3	7
2	Law recognizes non-possessory pledge in tangibles.	10	4	2	5	6
3	Law creates a property interest that allows holder to execute against the security.	10	4	2	5	8
4	Law allows flexibility in the type of security interest created, and nature of the interest secured.	10	10	2	2	4
	SUB-TOTAL	40	16	7	15	27

Tier III Indicator "B.1.3"

Indicator Identifier

Tier II Indicator

Reference Value for "Legal Framework"

commercial law environments. Tier II indicators provide an intermediate level of detail, and are

[6] Tier I indicators consist of the sum of twenty-eight Tier II indicator values (i.e., four "dimensions" each for 7 substantive areas of law under consideration) for each country analyzed.

intended to be useful in program design and management where diagnosis and resource allocation are key concerns.

Tier III indicators provide the bedrock for this analysis. In Fig. 2 above, Tier III indicator values are assigned based on the findings of the diagnostic teams. The Tier III indicators are summed to yield the relevant Tier II indicator characterizing the legal framework for collateral law.

> ***"Yet having begun, we must go forward to the rough places of the law…."***
>
> **Plato's Republic, Book V.**

As noted above, 7 areas of substantive law are being considered in this study. The three tier approach outlined above, while admittedly complex, is intended to provide both the level of detail required by a specialist; yet the degree of abstraction required by senior program managers and policy makers as they address macro-level issues.

V. Narrative Summary of Diagnostic Findings

A. Bankruptcy Law

Legal Framework

Ukraine's bankruptcy law dates to the early days of the post-Communist period. The Law "On Bankruptcy" was adopted on May 14, 1992 (Law No. 2343-XII) and subsequently modified on June 17, 1993, February 25, 1994, and in March 1995. The law gives few rights and protections to creditors and does not allow for debtor-led reorganization. Also the law applies solely to legal entities, leaving untouched individual entrepreneurs and non-business bankruptcies.

In the area of creditors' rights, the law is defective by unduly restricting the circumstances under which a creditor may file a bankruptcy petition. Creditors are only permitted to file bankruptcy petitions *after* their claims have been liquidated in the civil courts and they have been unable to collect on their judgments. Article 5 of the Law on Bankruptcy states that "a creditor can file a petition commencing a bankruptcy case against a legal entity which fails to satisfy an acknowledged obligation within one month after performance is due or to satisfy a debt which is evidenced by certified documents." Since it is extremely rare for a debtor to admit the debt in writing, the creditor must first bring an ordinary debt collection action with the incumbent delay and expense related thereto. As there are costs associated with court proceedings, the creditor must pay the required 5% state duty for civil actions in advance. Once a judgment is obtained, the creditor then serves the writ of execution on the debtor's bank, and if there are insufficient funds in the account, must wait 30 days for a certificate of non-payment from the bank. Only after the certificate of non-payment is obtained may the judgment creditor file a bankruptcy petition (paying an additional 0.5% state duty).

Under the law, notice is *not* given to other creditors until 30 days after filing of the bankruptcy petition. If the debt is paid before this notice is sent, the filing creditor may discontinue the case, leaving other creditors in the position of starting the process all over again. This delayed recourse to bankruptcy protection leaves much to be desired in the protection of creditors' rights.

The second principal defect in the existing law is that it is completely devoid of any of the tools necessary to restructure an enterprise. Debtor-led reorganization does not exist because should a debtor file for bankruptcy, it would immediately lose control of the company. The main choices under the existing law are liquidation and *sanation*—which involves an effort to separate the salvageable parts of the company from those that will be liquidated. The "sanation" provision assumes that an outside "sanator" (investor) will agree to assume all the debtor's debts in exchange for an ownership position. In practice, sanation rarely takes place so it merely becomes another form of liquidation.

Other significant defects in the current law are (i) the provision that allows legal entities to serve as trustees and liquidators, resulting in a lack of accountability, and (ii) the requirement that creditor decisions be made by creditors holding two-thirds of the total debt, rather than a simple majority.

Over the past four years there has been a growing consensus among reformers and their supporters in the legislative and executive branches to abolish the law and start again. The proponents of reform have argued for a bankruptcy law that would eliminate the above defects.

Reformers have focused on six key changes in the law:

- Broad, powerful, and flexible reorganization provisions would allow the debtor, with the consent of creditors holding a majority of debt, to plan and implement its own reorganization plan.
- Amicable settlements between the debtor and creditors would be allowed.
- In the aim of generating internal capital for the company to continue operating, there would be a moratorium on debt payments upon filing.
- Explicit authority for debt forgiveness is provided, including forgiveness of all taxes more than two years old, with up to six years to pay off taxes less than two years old.
- To increase accountability and transparency, only natural persons who have been trained and licensed would serve as reorganization and liquidation managers.
- Creditor voting processes would be streamlined and calculated to produce decisions. Creditor decisions would be taken by majority vote of the debt present, and bind dissenting creditors.

The new law would make reorganization the first choice, with liquidation the last resort. The reorganization provisions provide the flexibility to do almost anything legal and necessary to reorganize successfully. It provides, for the first time, a way to deal with huge tax debts accumulated under prior confiscatory rates. Simple mechanisms would promote agreements by the parties.

On June 30, 1999 after months of debate, the new bankruptcy law—the Law of Ukraine on Restoration of the Solvency of the Debtor or Declaring it Bankrupt—received final approval by the Verkhovna Rada, Ukraine's parliament. There were substantial changes from the version of the law passed on second reading. After June 30, the law then went through final editing by the

Parliament's legal and editing department, a practice not intended to change the substance of the law. The law has now been presented to the President, who can either sign it or veto it. As of August 15, 1999 the President had not yet acted.

Without having reviewed the actual, final text of the law, it is not possible to say to what extent the new law meets the objectives of the reform constituency that promoted it. We do know that last minute changes to the amicable settlement agreement provisions (Article 39) of the law, apparently intended to strengthen the debtor's hand, will probably have the opposite effect to what was intended by making it more difficult for the debtor to get creditors to agree to forgive debt. Also a new clause requires that only creditors with "indisputable claims," a defined term, can file for bankruptcy. This would appear to require creditors to go through the same kind of arbitrary, expensive, and time-consuming "action proceeding" to liquidate their claims before filing as they do now. If so, this would carry forward into the new law one of the least desirable aspects of the old law. Of course, any definitive comment must await the final text of the law.
In short, Ukraine's existing Legal Framework for bankruptcy is seriously flawed, and the extent to which the situation will be improved by a new law that is awaiting Presidential signature remained unclear as of August 1999. The numerical scores attached to the Legal Framework indicators show lower scores for Ukraine than given to Poland, Romania, and Kazakhstan.

Implementing Institutions
There are two implementing institutions for bankruptcy in Ukraine:

- The Agency for Bankruptcy is responsible for training and licensing arbitration managers and has been a strong proponent of reorganization.
- The arbitration courts actually hear and decide bankruptcy cases, and there is a hierarchy of arbitration courts headed by the Supreme Arbitration Court of Ukraine.

According to statistics compiled by the Agency for Bankruptcy, there has been a growing volume of bankruptcy cases in Ukraine. During 1996 there were 6,562 bankruptcy cases which increased to 9,645 cases in 1997. In 1998 that number increased to 12,281. Within these figures are a considerable number of unresolved cases that were carried forward from the prior year.

Most of bankruptcy cases are filed by tax authorities. Ukraine's tax law also encourages creditors to file because bad debts cannot be written off without a determination by the arbitration court that the debtor is bankrupt. Although stiff filing fees make bankruptcy an expensive proposition for large creditors, bankruptcy is used as a debt collection device by smaller creditors who can afford the filling fees. The pattern in such cases is that the creditor files a petition, is paid off by the debtor, and then withdraws the petition. Debtors almost never file for bankruptcy.

The vast majority of these cases involve liquidation and not sanation. According to Agency for Bankruptcy statistics, the number of sanations and liquidations ordered by the court were, respectively, 33 and 855 in 1996, 32 and 2320 in 1997, and 9 and 2896 in 1998.

Many of these bankruptcy cases ultimately involve corporate shells that have literally no assets and are only fit for liquidation. Bankruptcy cases may linger for years, while assets waste away. Large state-owned enterprises typically continue to operate while insolvent. When unable to continue, production is shut down without filing for bankruptcy, in the hope of a future restoration of the business. Many private sector bankruptcies occur in situations where promoters set up a private trading company, do one large transaction, and then abandon the company without paying creditors or tax.

Although the courts may invalidate fraudulent transfers of company property within specified periods before bankruptcy, they seldom do so. There are two voidable preference periods specified in Article 15 of the current law. First, the arbitration court may void any sale of the debtor's property made within three months prior to the start of insolvency proceedings if the transaction was effected to further the interests of a creditor (or another party with interests in the debtor). Second, the arbitration court may void any sale of the debtor's property made within one year prior to the start of insolvency proceedings if:

> (i) the transaction has as its objective the concealment of property in order to avoid the payment of debts,
> (ii) the sale price is substantially below the fair market value of the property, or
> (iii) the debtor is insolvent on the date of sale or has become insolvent as a result of the sale.

As a matter of practice these preferences are rarely recovered.

Supporting Institutions

From an institutional point of view, the role of the arbitration courts and the Agency for Bankruptcy as implementing institutions must be supplemented by a community of experts who understand the bankruptcy process and can effectively implement the bankruptcy laws. This community of experts is considered the Supporting Institutions for purposes of this diagnostic. Supporting Institutions include trustees, clerks, appraisers, liquidators, crisis managers, bankers, lawyers, etc.—all of whom are willing and eager to implement the bankruptcy laws.

To date, practically none of this support structure for bankruptcy exists in Ukraine.
Given the weaknesses in the Legal Framework and Implementing Institutions for bankruptcy, it would probably be unrealistic to expect that the Supporting Institutions would be much stronger than they are. The current weakness of the sanation option in existing law and the heretofore lack of mechanisms for reorganization serve to dampen the growth prospects for Supporting Institutions.

In a market economy, the decision to reorganize or liquidate turns on which option pays the greatest dividends to creditors. But in Ukraine the mechanisms for reorganization do not exist, and the liquidation of asset-stripped enterprises does not pay enough to support Supporting Institutions.

Lastly, since no compensation to Supporting Institutions is specified in the law, there is no incentive for them to develop.

The "Market" for Bankruptcy Reform

The "Market" for bankruptcy reform in Ukraine is not robust. This should be evident from the prior sections and is reflected in the numerical scores attached to the "Market" indicators for Ukraine. These indicators point out the deficiencies both in the Supply and Demand side of the equation.

On the Supply side, there are problems both with the substance and the process of the law. Everyone knows that the existing bankruptcy law is defective and about to be replaced—hopefully with a much better product. Until there is an effective, user-friendly law in place, it will be hard to generate much enthusiasm for bankruptcy as an institution.

Reacting to imperfections on the Supply side of the ledger, banks and the private sector have not heretofore devoted much attention to bankruptcy. Creditors have developed their own debt collection (i.e. strong arm) methods unrelated to the bankruptcy laws. Bankruptcy does not fulfill the efficient market-clearing mechanism that it does in the West. In Ukraine, no market presently exists to operate as an exit mechanism for loss-producing enterprises. Demand for the Agency for Bankruptcy's training sessions is strong, even before enactment of the law that would create paying jobs for arbitration managers. But this interest has not been translated into a generalized demand for bankruptcy law reform. Hence, as of this writing, the "Demand for Bankruptcy Law" cannot be said to be vigorous.

With a good law in place and a demonstrated serious commitment by government to see it enforced, demand should change, which is when the community of bankruptcy experts will take root. Once this happens, they will start to organize themselves to advocate and lobby for improvements in the law. As the pace of reform quickens, new interest groups form and the policy agenda becomes more extensive. Liberalization of the business environment can be a powerful catalyst, setting off a virtuous cycle where each reform makes the next one easier.

At the moment, this goal seems a long way off in Ukraine.

B. COLLATERAL LAW

Legal Framework

The Ukraine moveable property pledge registry ("Registry") became operational on March 1, 1999, which ushered in a new era for lending secured by moveable property in Ukraine. In conjunction with amendments which allow for so-called self-help seizure upon default, the creation of the Registry will take Ukraine several steps forward in the development of a fully functional secured financing system.

Creation of the Registry was designed to address the drawbacks of the prior law—i.e. the Law of Ukraine On Pledges dated October 2, 1992. Under this law, pledgors were required to keep a "Book of Pledge Entries" in which all pledges on their property were to be noted. The reliance on pledgors to provide notification of existing pledges resulted in considerable fraud. Desperate or dishonest pledgors had both the incentive and ability to create numerous pledge books in order fraudulently to obtain additional financing. While the pledgor was liable for fraudulent entries in its pledge book, the pledgor often had no resources to compensate affected lenders once the fraudulent pledge books came to light.

As a result of these and other problems with the Pledge Law, the Ukrainian parliament amended the pledge law in late 1997 to provide for the creation of the Registry for movable property. The Pledge Registry System was developed with assistance from experts familiar with the American Uniform Commercial Code Article 9 and the Canadian Personal Property Act notification systems.

The amendments called for the Cabinet of Ministers to promulgate implementing regulations and also to determine the final location of the Registry. The general language of the amendments gave significant discretion to the Cabinet of Ministers in creating the Registry to minimize potential opposition at the legislative stage.

The implementing regulations, namely "Procedures for Operating the State Moveable Property Pledge Registry," approved by Resolution of the Cabinet of Ministers No. 1185 on July 30, 1998 ("Regulations"), flesh out many of the issues left open by the general language of the 1997 Pledge Law amendments. The Regulations are relatively straightforward and contemplate the creation and operation of a user friendly Registry.

The Ministry of Justice ("MOJ")was selected as the implementing entity, with its wholly-owned entity StateInfoJust, charged with administration of the system. StateInfoJust interacts with customers directly or through its central registry and 25 regional offices. In addition, state notary offices, private notaries, and commercial banks may serve as registry offices. Parties to pledge agreements will therefore have a choice as to whether to register a pledge directly with a StateInfoJust entity or instead to go to their local bank or a local notary.

This structure varies from the original concept in one important respect. It was always contemplated that the pledge registry system would operate over the payments clearing system of the National Bank of Ukraine ("NBU") to which all banks in Ukraine are connected, in order to give banks (initially expected to constitute 95% of pledgees) direct access to the registry. Connectivity with the NBU system is still an important goal, but it is not as automatic as it once was. Prior to any use of the collateral registry system, commercial banks must have signed an agreement with the MOJ on terms of use, liability, service, and cost. As of March 1999, 13 commercial banks were considering connectivity to the system.

Related to collateral pledges is the creation by decree of a so-called "tax pledge" during the summer of 1998. The tax administration is entitled to place the property of delinquent taxpayers under a tax pledge that, in turn, severely limits the ability of the debtor to sell the property subject to the pledge. The state tax administration is required to register any tax pledges in the Registry in order to ensure it retains its priority in the property of a delinquent taxpayer over subsequent pledge holders. This gives creditors a public mechanism whereby they may determine whether the priority of their pledge will be undermined by the existence of prior outstanding tax liabilities, avoiding the problems of secret tax liens which have plagued Central and Eastern Europe.

Implementing Institutions

The first of its kind in the former Soviet Union, the new Ukrainian Pledge Registry is a state-of-the-art system designed to reduce the type of fraud resulting from the previous pledge law's ineffective provisions governing third party notification of existing pledges or liens. The amendments also simplify the pledge law's provisions governing seizure of property subject to lien after debtor defaults.

The creation of the Registry and the corresponding public access to information about debtors are clearly critical steps in ensuring that creditors obtain real value from taking a pledge on moveable collateral (that real value to be presumably passed on to borrowers in the form of lower interest rates and/or longer loan terms).

However, the Registry is new and there is a long way to go before it can be said to be institutionalized. System hardware and software were being tested during March 1999. The first substantive task was to re-register 30,000 existing pledges. As of June 30, 1999, some 25,000 pledges had been registered in Ukraine. Also, 80,000 existing tax liens need to be registered. This is more work for the Registry but is something that the commercial bank customers want (and need) very much—so it must be treated as a priority.

The key implementing institution is the Ministry of Justice, with support from the National Bank of Ukraine. Because of the inclusion of tax pledges within the Registry, the State Tax Administration may become an implementing entity but at the moment its role is more "supporting."

The Regulations provide for registration of pledges on the application of a pledgor or pledgee with a Registrar or directly with the Registry. The registrar is to register a pledge within 2 days of receipt of a completed pledge registration application. The cost of registration and obtaining extracts from the Registry is quite low, the equivalent of about $10 and $5, respectively, at March 1999 exchange rates.

The application process is quite simple, and the application must only contain:

1. Identifying information on the pledgor and pledgee (name, address, and for Ukrainians, either the individual's identification number or the identification code in the Centralized State Registry of Enterprises and Organizations in Ukraine; foreign entities are required to give their country of official registration), and

2. A general description of the collateral except if the collateral is in the form of moveable property subject to state registration such as vehicles, combines, ships etc. In that case, the serial number, name of the model, and year of production must be added to the general description of the collateral.

Supporting Institutions

In making the collateral law a reality, a key role has been played by a Working Group chaired by the Ministry of Justice that has distinguished itself by its stability and cohesiveness. In addition to the implementing institutions identified above, the group includes the Association of Ukrainian Banks, which represents the interests of one set of customers; the Supreme Arbitration Court, which made important suggestions in the statutory and regulatory area; and the State Tax Administration, which is particularly interested in the tax pledge provisions.

The "Market" for Collateral Law Reform

As is evident from the above discussion, the "market" for collateral law reform is much stronger than exists for bankruptcy. Although not perfect, the new collateral and pledge registry law and regulations were sufficiently attractive to the Ministry of Justice, the commercial banks, the National Bank of Ukraine (NBU), and the State Tax Administration in order to create a genuine public/private partnership. Considering that the amendments to the Pledge Law were adopted in late 1997, this reform has moved quickly.

One impressive feature is the recent positive action on the demand side. Commercial banks, the NBU, and the private sector have already started lobbying for improvements and refinements in the system. This is a good sign that shows their commitment and interest in the particular reform area. And, perhaps it signals the start of a "virtuous cycle" on collateral law where each reform makes the next one easier.

One must not be blind to the challenges ahead. In many transition countries pledges may be feasible on paper but they are stymied by pitfalls in the registration system or by cumbersome foreclosure procedures. Ukraine's registry has only just begun. Yet still, the past year's accomplishments on the registry are quite impressive for a country that in many reform areas has lagged behind its neighbors.

Of course, the bottom line is whether there are increased amounts of credit and/or better loan terms available to private entrepreneurs through commercial lending attributable to the new collateral law and registry. We have to be patient on this but still this is the result that we are seeking. It cannot be ignored indefinitely without undermining the assumption on which this assistance is based.

C. COMPANY LAW

Legal Framework

Ukraine's company law is the "Law on Business Associations" dated September 19, 1991 (Law of Ukraine No. 1577-XII) as subsequently modified. Ukraine recognizes five business organizations: the joint stock company, limited liability company, additional liability company, full liability partnership, and limited liability partnership. The first two are currently the most commonly used form of business organizations in Ukraine.

The company law was enacted at the beginning of Ukraine's independence to serve as the legal base for private business undertakings in contrast to state companies. Since then, the law has been changed little and provides few of the protections found in Western corporate law. The weakest area is corporate governance—the duties and responsibilities of directors and the protection and rights afforded to shareholders.

In 1998 a new draft Joint Stock Company law was prepared with the assistance of foreign experts which would have created a framework for private sector companies that is familiar to western businessmen and lawyers. However, the law was not enacted, and passage is not anticipated in the near term.

One of the greatest weaknesses in the existing law is the protection of shareholder rights. Shareholder rights are commonly defined as the right (i) to participate in a company's affairs through attendance at shareholder meetings and voting rights, and (ii) to participate in profits in the form of dividend payments and claims upon liquidation of the company. The fiduciary duties that in most legal systems run from directors to shareholders are totally lacking. The responsibility of general managers/directors to the shareholders is limited to gross negligence only.

The problem's in protecting shareholder rights is particularly acute for minority shareholders generally and in cases where share participation is limited by law. For example, Ukrainian legislation limits foreign participation to 49% or less in certain sectors such as publishing houses, insurance, and privatized "strategic" enterprises. In fact, even when foreign investors are majority shareholders, they may be the target of legal and extra-legal harassment. One U.S. law firm advises its clients that 76% should be the minimum investment in a Ukrainian company. Anything less is an invitation to stalemate or worse.

The complexity and cost of procedures for registering a business has been a persistent problem in Ukraine. The simple act of officially registering a business has grown into a complicated multi-stage procedure requiring extensive time and money. While this situation may have been just an annoying nuisance for rich, established firms, it created an insurmountable barrier to some entrepreneurs struggling to begin operations. Recent improvements in this area are described in the below section on Implementing Institutions.

Apart from recent improvements in legislation governing business registration, the existing legal framework for company law in Ukraine remains seriously flawed. The numerical scores attached to the Legal Framework indicators are lower for Ukraine than for Poland, Romania, and Kazakhstan.

Implementing Institutions

The registration of companies in Ukraine is handled at the district (*rayon*) level. Each district has its own registration office. The registration procedure is mainly regulated by Article 8 of the "Law on Entrepreneurship" dated 26 February 1991 and by the regulations of the Cabinet of Ministers. Many of the required documents and steps in the registration process are similar to those found in other countries. Some documents, such as the approval of the Anti Monopoly Committee and the identification code of the Statistic Committee, are additional requirements that may be time-consuming but are not generally onerous. However, local registration bodies have tended to follow their own internal instructions on registration in preference to the controlling legislation. Many have been inventive in creating "additional requirements" and finding reasons to refuse registration. The most frequent "additional requirement" is the "mandatory contribution to the social fund of the registration body" prior to the registration. Another popular "additional requirement" is the submission of the property certificate of the premises rented by the entity to be registered. Registration bodies often refuse registration with the argument that the submitted documents are not in conformity with Ukrainian law. Frequently, corporate charters and foundation agreements have to be redrafted several times. This is true even where they are within the limits of the law and strictly regulate the parties' relationship and accordingly do not affect the public interest.

After years of mounting complaints from domestic and international business groups, and to meet World Bank conditionality, the Government simplified the business registration procedures by amending Article 4 of the Law on Entrepreneurship. The reformed procedures were made operational by Cabinet of Ministers Resolution No. 740 On the Procedure for State Registration of Entrepreneurial Activities of May 25, 1998. The new procedures came into force on July 3, 1998 and in essence state that the local office must register a business within 5 working days from submission of the specified documents. Once a company is registered, the taxation authorities must register the company within 2 days from the submission.

In September 1998, the Regulatory Reform Project of IRIS and International Finance Corporation (IFC) organized a study to determine the impact of the changes in the Law on Entrepreneurship on business registration practices. Approximately 200 in-person business surveys were conducted in three regions of Ukraine—Sumy, Zhytomyr, and Lviv—with firms that had registered in the period after the new regulations had come into force.

The study found clear evidence of improvements in the business registration system. The average time required to complete the business registration application process was 3.8 days. This is well within the legal stipulated five-day period and is a significant improvement from the situation in the fall of 1997. A total of 9.0 days were required by the average respondent to assemble all the required documents, submit an application, and be formally registered. The same process took 34.7 days under the old registration system.

Also the costs of business registration were cut substantially. Costs include fees paid directly to the state and fees paid to notaries, accountants, and others to prepare the necessary documents. The average total cost of business registration was 200 hrivna—which compares favorably to the 383 hrivna that was required to register a business under the old system.

The study also found a wide divergence in the average cost and time required to complete registration in the three regions, indicating that the implementation of registration procedures was strongly affected by the behavior of local officials. For example, the researchers found evidence that sole entrepreneurs registering in Lviv had been charged 8 times more than they were charged in Zhytomyr and the process took days longer.

The business registration system has definitely been improved, but whether the new system becomes generalized countrywide is not yet clear. Similar reforms have been attempted before, and after a burst of reforming energy the situation reverts to the *status quo ante* because of the pressure on local governmental units for off-budget financing and the well established practice of rent-seeking by officials.

Supporting Institutions

This area is practically in its infancy in Ukraine. In the West, universities, foundations, think tanks, business associations, etc. are key participants in the public policy dialogue that leads to improved corporate governance and protection of shareholder rights. However, this support structure for company law does not exist in Ukraine.

Perhaps the only consistent advocacy for change in the company law area comes from foreign banks, law firms, and accounting firms. To date, their efforts are more like a crying for help in the wilderness rather than a coherent policy dialogue that is likely to change the situation. Ukrainian counterparts seem more reconciled to the status quo, having developed their own individual survival strategies.

The "Market" for Company Law Reform

To date, the demand for company law reform in Ukraine has been fairly muted. The most pressing need is corporate governance—especially the duties and responsibilities of directors and the protection and rights afforded to shareholders. However, the supply of laws in this area is poor and things do not look any better on the demand side.

The most promising area for seeing how the "market" for company law reform might develop has been in reforming business registration procedures. The IRIS/IFC study seems to show that it is possible to detect and quantify an improvement in regulatory practices produced by a change in legislation. Registration practices did improve due to the simplicity of the new procedures, and the explicit description of all procedures in the implementing regulation. These are features that should be included in the drafting of all subsequent regulations. This is a valuable Lesson Learned for the Supply side of the "market" equation.

The IRIS/IFC study also has some interesting observations for the demand side as well. The Konotop City Administration (in the Sumy region) has demonstrated the capacity of local officials to multiply the impact of reform. In Konotop, business registration has gone from being a government-sanctioned nuisance and barrier to entry to being a model of government-business cooperation. Not a single instance of refusal or delay in registration was recorded in the entire Sumy region. Local officials can be active participants in regulatory reform as long as they are convinced of its benefits. Once the ball starts rolling on the demand side, then the private sector and civil society pick it up and keep the momentum going. But will this burst of demand activity be a passing fad or a permanent change? Bursts of activity and/or progress should be monitored in the future for possible Lessons Learned for other areas of reform.

D. COMPETITION LAW

Legal Framework

Ukraine's competition law consists of the Law on Restriction of Monopoly Practices and Prevention of Unfair Competition in Economic Activity of 1992 and the Law on Prevention of Unfair Competition of 1997. The activity of the Antimonopoly Committee, which is the principal implementing agency, is regulated by the Law on the Antimonopoly Committee of Ukraine of 1993.

Ukraine, as all other former Soviet republics, inherited a highly concentrated industrial structure with a completely monopolized distribution sector. Retail trade monopolies began to break up slowly already in Soviet times, but the production and wholesale sectors remained dominated by state-owned monopolies or enterprise associations. Ukraine had no experience in promoting competitive practices. On the contrary, the existing state structures were in charge of establishing socially acceptable prices and preventing speculative transactions.

> *Manufacturing and commercial monopolies owe their origin not to a tendency imminent in a capitalist economy but to governmental interventionist policy directed against free trade and laissez faire.*
>
> *Ludwig Mises, "Socialism"*

Given this situation, the country has made remarkable efforts in developing antimonopoly legislation and practices. The legislation of Ukraine, developed with substantial international assistance, provides the base for vigorous enforcement of sound competitive principles, particularly in the area of the protection from unfair competition.

The competition law defines in detail such terms as "monopoly position," "monopoly prices and activities," and "monopoly associations." The law generally prohibits agreements between market participants that distort or prevent domestic or regional competition. The law also prohibits abuse of monopoly power, including discriminatory prices and practices for selected customers. Specific provisions prevent local or central authorities from discriminating against particular market participants in favor of other market participants. The law also provides for the compulsory break-up of the existing monopolies, and specifies the possible exceptions from this rule. The law restricts in equal manner the formation of vertical and horizontal monopolies. Finally, the law provides serious sanctions for violations.

There are several perceived deficiencies in the existing legislation. First, the law does not regulate state assistance as a form of unfair competition, thus permitting anti-competitive advantages to some firms, particularly in the production sector. Several privatized major enterprises now enjoy a favorable position not only vis-a-vis potential foreign competitors, but also with respect to the local competition. While positive discrimination is clearly prohibited by the law, the more favorite treatment of particular competitors is not. Second, the law requires burdensome pre-establishment and pre-merger reviews in all cases, without any specific threshold. This is in fact a licensing procedure for all economic activities. Although the implementing institutions maintain that such review is a formality, with permission given in all cases, the existing procedures may be effectively used to prevent competitors from entering the market. Besides, they result in a misallocation of resources from productive activity simply to satisfy unnecessary formal requirements.

Finally, the law exhibits some of the technical weaknesses common to much post–Soviet legislation in the region. It refers to action by the Anti-Monopoly Committee (AMC) "pursuant to the applicable legislation" but does not specify the applicable legilslation. In fact, in most cases there is no corresponding legislation. This leaves wide discretion for the AMC and makes arbitrary action possible. (For example, see Section 14 on pre-formation and pre-merger control, and Sections 23-1 and 23-2 on the procedure for taking decisions in particular cases).

Section 24, regulating the procedure for appeal from AMC decisions, is particularly unclear. While it authorizes appeals before the courts of general jurisdiction or the arbitration (*arbitrazh*) courts, but does not specify the procedural rules applicable to the appeals, nor define the jurisdictional differences between the arbitration courts and the general courts. Although each court has applicable rules of procedure once a case is within the system, these rules do not expressly foresee appeal from decisions of a government agency such as the AMC, but deal with lower court decisions.

The Law on Prevention of Unfair Competition[7] is an improvement on the 1992 law, as the former is better organized and more modern. It defines in detail the cases of unfair competition in the use of trade marks, industrial samples or good will of competing companies, and of unfair business practices (e.g., discriminatory agreements, use of trade secrets, unfair use of competitors' employees, and unethical professional behavior). Implementation of the law is restricted, however, by the lack of clear procedural rules and other implementing legislation.

The Law on the Antimonopoly Committee of Ukraine[8] establishes the territorial structure and appointment of the members of the AMC. It fails to provide the procedures for making decisions, and it contains several ambiguous provisions. Particularly unclear are the intended obligations of the AMC to "address" the courts when necessary and to "coordinate" the work of the Committee with the office of the *Procuratura* (similar to an Attorney General). While "coordination" appears to be simply a role of working with institutions of equal importance, the law does not define the AMC's authority or function.

Implementing Institutions

The Antimonopoly Committee of Ukraine is a state agency, established by the Supreme Council of Ukraine and subordinate to the Government. It consists of a Head, appointed for a seven-year term by the Supreme Council, and ten State Commissioners. The Head of the Antimonopoly Committee is member of the government. The Committee maintains a network of local

[7] Dated June 7, 1996, most recent amendment November 11, 1997.
[8] Dated November 26, 1993.

subdivisions, which follow the administrative division of the country, with a total staff of about 600 people.

As many other government agencies, the Antimonopoly Committee suffers from high turnover of qualified staff, inadequate facilities, and limited allocation of budgetary resources.

In 1998, the Committee identified and prosecuted 1,711 cases of violations of the antimonopoly legislation, which represented an increase of over 1.7 times compared with 1997. The cases prosecuted pursuant to complaints from affected economic entities or individuals increased more than 3.3 times (599 in 1998, compared to 184 in 1997), representing 35% of the total caseload.

In 1998, the number of cases against the (primarily local) state administration for discriminatory practices against particular economic entities increased markedly. Of the 574 cases brought, approximately 20% were related to imposition of illegal taxes and other fiscal measures that restricted the ability of new participants to enter the market; 18% were cases of forced contracts; and 30% were restrictions on the purchase of particular commodities by various economic entities. Particularly serious are the cases in which local and central authorities require private businesses to enter into contracts with unnecessary intermediaries between the state administration and the users of government services (i.e. companies “facilitating” customs processing or company registration), or to obtain mandatory insurance from a specific insurance company.

Such a caseload is indicative of the continuing, inappropriate strong state involvement in the economy, particularly at the local level, and the ability of the local authorities to influence business decisions in both formal and informal manners. For comparison, there are almost no such cases in the reforming economies of Central and Eastern Europe.

The Committee has generally concentrated its price control activities in the natural monopolies sector, assuming that natural monopolies are most likely to abuse their economic position. The increases in the cost of communal services (different utilities) and the local transport have been particularly targeted and represent over 60% of all cases of abuse with monopoly position. But the emphasis on the activities of the natural monopolies turns the Committee into a mostly regulatory agency involved in price formation, at the expense of other monopoly activities, such as anti-competitive agreements and restrictive contractual practices. Excluding the cases against the natural monopolies, in 1998 there were 32 cases against other monopolies and monopoly practices (compared with only 14 cases in 1997). Those included 14 cases of monopolistic and discriminatory price formation, 4 cases of market distribution agreements and 14 cases of practices, representing barriers to entry.

The Committee does not maintain statistics disaggregating pending cases and the total number of cases opened in one year. The available statistics represent the total number of "identified" cases.[9] There is currently no statistical information on cases completed in one year.

Supporting Institutions

It is difficult to assess the role of supporting institutions in the enforcement of the antimonopoly legislation in Ukraine. The dual court system and the unclear procedural regulations prevent the collection of data about those cases that eventually do reach the courts. The office of the Attorney General (*Procuratora*) may also play an important role, particularly in the prosecution of criminal cases related to unfair competition. In the absence of clear rules for coordination of the activities between this office and the Committee no such cases have been reported. No data exists regarding cooperation of the Committee with business associations or non-governmental organizations (NGOs) to protect the consumer rights. Such NGOs are only at the initial stage of formation in Ukraine, and so far have not submitted cases to the Committee.

The Market for Competition Law Reform

Ukraine is a country in which the functions of many government agencies are not yet clear and well established. The procedural rules for most of those agencies seem particularly underdeveloped because of the lack of tradition and of "institutional memory". The representatives of the Committee expressed particular interest in assistance in this area.

Antimonopoly legislation in Ukraine suffers less from conceptual problems than other branches of the law (i.e. property, contracts or company), but it still needs improvement. The law needs to be unified (at present there are three laws with overlapping functions and conflicting provisions). The functions of the Anti-Monopoloy Committee as a regulator of natural monopolies should be transfered to specialized regulatory agencies, as has occurred in other reforming economies in Europe. Experience in this area in Ukraine seems to be particularly inadequate.

Both supply and demand for change are adversely affected by the involvement of the state in monopolies. Legislation limiting anti-competitive behavior must be issued by the state, but the Government of Ukraine owns many of the monopolies that should be regulated by the AMC. At this time, there is insufficient political will to disengage from either monopoly ownership or monopoly practices. Any demand for change by the AMC or by outside groups is likely to meet a wall of resistance. Consequently, the AMC will be unlikely to supply the necessary regulatory measures to bring about change with state enterprises. This is a serious issue for reform.

Demand seems to be stronger for organization of implementing agencies, reduction of the workload through better identification of the cases in which the involvement of the Committee is necessary, and interaction between the Committee and other government agencies and state institutions, particularly the court and the Office of the Attorney General (*Procuratora*).

[9] "Identified" cases are the cases for which the Committee concluded that there is some violation of the applicable laws that merits further prosecution. The number reflects all cases, which were started pursuant to a complaint from affected private parties and pursuant to independent action by the Committee.

The establishment of NGOs, concerned about consumer protection, seems to be another priority. Yet the formation of such organizations is impeded by the lack of funds and traditional non-involvement of private parties in administrative matters. There are indications that this involvement is increasing, but at a very slow pace and primarily due to the interest of the directly affected economic actors, not of the public in general.

E. CONTRACT LAW

Legal Framework

The Constitution of Ukraine[10] recognizes the universal protection of private property rights, which is the basis for all business contractual obligations in a market economy. Although the Constitution exempts certain assets and objects as the exclusive property of the state, even those can be included in contractual obligations to which the state is a party.

Ukraine's contract law is contained in the Civil Code[11] and in several other laws that deal with contracts specific to certain business activities—the Law on Leasing of State and Municipal Property, the Law on Leasing of the Property of State Enterprises and Institutions, and the Law on Commodity Exchanges.

> *But the operation of the wisest laws is imperfect and precarious. They seldom inspire virtue, they cannot always restrain vice. Their power is insufficient to prohibit all that they condemn, nor can they always punish the actions which they prohibit.*
>
> *Gibbon, Decline and Fall Of The Roman*

The original text of the Code was adopted at a time when private property was not recognized as the basis of economic activity. The Code was designed to deal with a limited number of transactions between individuals and was completely inadequate for the needs of a market economy. Subsequent amendments of the Code increased the contractual freedom of the parties and the types of contracts recognized by the law. The Code also adopted the basic principle that contracts that are not contrary to law can be recognized, even if not specifically regulated by the Code. Yet the general system of contract law in Ukraine still has some inconsistencies and needs to be brought in line with the fundamental provisions of the Constitution.

Ukrainian law is only beginning to distinguish between business and non-business transactions, and to recognize involvement by individuals in business transactions. During the Soviet period, the Civil Code had only marginal importance in regulating commercial relationships. Only entities (cooperatives) could participate in commerce legally, and individuals could not.

As times have changed, the law has lagged behind. Courts are, however, coming slowly to recognize theoretical differences between business and non-business transactions and to treat

[10] Adopted by the 5th Session of the Supreme Council of Ukraine, June 28, 1996)

[11] *Civil Code of Ukraine*, adopted on July 18, 1963, amended as follows: (i) Soviet Period - Amendments and Modifications to Civil Code made according to Decrees of Presidium of Supreme Council of Ukrainian Soviet Social Republic dated: 23 November 1966; 24 June 1969; 22 July 1970; 29 March 1973; 5 June 1973; 15 October 1973; 13 September 1974; 10 April 1975; 25 April 1975; 6 December 1976; 22 December 1976; 19 August 1977; 1 March 1985; 20 May 1985; 27 June 1986; 21 August 1987; 24 December 1987; 25 October 1988; 28 January 1991; and (ii) Post-Independence - Amendments and Modifications according to Laws of Ukraine dated: 7 July 1992; 14 October 1992; 22 April 1993; 5 May 1993; 6 May 1993; 16 December 1993; 4 February 1994; 15 July 1994; 14 December 1994; 28 February 1995; 11 July 1995; 6 October 1995; 3 December 1996.

them differently. In deciding disputes, courts will look beyond the insufficient provisions of the code to determine various features of business relationship, such as:

- the nature of the parties (legal entities or individuals, registered with the State and involved in business activities);
- special business relations regulated by the contract (primarily activities related to property, other than property transfers arising from consumer transactions between individuals);
- special forms required for conclusion of contracts;
- any special liability of the parties, including product liability.

Although the law in Ukraine requires the registration of all business entities and individuals involved in commercial activity, failure to register does not necessarily affect treatment of a party. In other words, for example, an individual cannot expect to be held to a different standard of care (as a consumer rather than a professional business person) simply because he or she has not registered to do business. The courts will look beyond these formalities to determine proper practical standards for interpreting contract disputes.

The Law on Commodity Exchanges, while specialized, may serve as an important basis for development of contract law in the Ukraine, despite the decrease in commodities contracts in recent years. This law was designed to fill a gap in treatment of commercial contracts by the Civil Code. Although it is limited to a specific number of transactions (registered trades of goods at commodity exchanges) and specific participants (members of the exchange), the law recognizes and regulates a number of contracts, not recognized by the Civil Code. This provides a legal basis for the courts to enforce such contracts without the argument that they are contrary to the law.[12]

In particular, the law regulates the following contracts:

- Forward contracts – contracts which require future delivery of goods under terms established at present;
- Guarantee contracts – contracts under which a certain amount is paid in the present as a guarantee of fulfillment of certain obligations in the future;
- Credit contracts – contracts under which certain goods are purchased by the broker with credit and the obligation to be sold at the exchange in the future;
- Premium contracts – contracts pursuant to which a certain premium over the spot price at the date of sale has been agreed in advance;
- Contracts with options to change the quantity of the goods delivered; and
- Futures contracts.

[12] Section 2, Article 4 of the current Civil Code provides that "civil rights and obligations originate from contracts (agreements) provided for in the law, and also from contracts not regulated by law, but not contrary to it. " Theoretically, all contracts that are not contrary to the law can be enforced, but practice does not always follow this principle. A specific reference to a legal provision regulating a particular contract is always helpful in an attempt to enforce such a contract.

By specifying these types of contracts, the Law on Commodity Exchanges expands the number of specific contracts which are expressly recognized as not being contrary to law. Although this is helpful in court, it does not satisfy the need to modernize the overall legal framework.

The existing system of contractual law in Ukraine exhibits several major problems:

- There is no specific special treatment of business contracts. The general rules are contained in a Civil Code that was initially designed to serve civil relations much more limited in scope. It is true that the Civil Code has been amended several times and that such amendments improved the situation somewhat, but they also compromised the internal logic of the Civil Code.
- Many of the new contractual forms are contained not in the principal law (the Civil Code), but in other legislation—for instance the Law on Commodity Exchanges. This lack of unity creates double standards in the interpretation of contracts.
- Different laws often establish different standards applicable to fairly similar situations. For example, the Law on Leasing of the Property of State Enterprises and Organizations provides that if a subsequent law changes the conditions for the parties involved, the old law will be applicable for contracts already concluded. No similar provision exists for contracts regulated by other laws. Instead of adopting a general principle established in the Constitution or in the Civil Code, such a piecemeal approach further complicates the task of the courts to enforce the law equitably.
- The law does not clearly establish whether a party to a contract can be found in default without a showing of fault or culpability for the default. Without "non-culpable" default, the use of contracts to establish liability for non-performance and apportion risk is deeply undermined. The draft revised Civil Code (not yet adopted) provides for such this possibility in commercial transactions, except in cases of *force majeure*.

Implementing Institutions

Dispute resolution for contractual matters in Ukraine is carried by the court system, which at present is divided between the courts of general jurisdiction and the arbitration (a*rbitrazh*) courts, which are in charge of dispute resolution of economic cases. The arbitration courts were created by transforming the State *Arbitrazh*, which in the period of centrally-planned economy and the monopoly of state-owned enterprises was in charge of dispute resolution between all economic entities. At present, the arbitration courts are responsible for all cases in which at least one of the parties is a registered economic entity. The Code of Arbitration Procedure, however, has not been updated to correspond with the role of the arbitration courts, for it still maintains the definition of “commercial” or “economic” contracts as “planned” contracts between economic entities, which are designed to serve the “basic economic purpose” of the contracting parties. Movements to modernize the Code of Arbitration Procedure are currently unsuccessful due to high level political pressures to maintain the status quo. This unfortunate situation is very damaging to the capacity of the judiciary to decide cases equitably under the rule of law.

Ukraine faces substantial problems in the establishment of an adequate dispute resolution system. The lack of experience in dealing with economic matters in the courts of general jurisdiction was used as a basis for assigning all economic cases to the former arbitration courts (which had experience, but the wrong type), and to postpone the establishment of a unified court system (as provided by the Constitution) for 5 years after the Constitution was adopted. This transition period is being used by the advocates of the existing system to preserve it. Until the year 2001 the Supreme Court of Ukraine will not be involved in economic cases and will not keep any statistics related to the work of the arbitration courts.

The assessment of the institutional framework in Ukraine cannot be carried out without taking into consideration the prevailing practices of barter transactions. In recent years, the Ukrainian economy has become increasingly de-monitized. Many enterprises have found themselves forced into barter by the existing macroeconomic situation and the confiscatory character of the tax legislation. This situation greatly limits the number of cases submitted to the courts, and prevents the establishment of institutionalized system of alternative dispute resolution (the real commercial arbitration). Commercial arbitration in Ukraine is in a nascent stage (with only four or five cases between domestic parties being submitted so far to the existing arbitration tribunals).[13] Moreover, the arbitration mechanisms are openly prejudiced in favor of local enterprises and are not currently perceived as developing into institutions that can be trusted by foreign investors. This lack of a competent commercial judiciary and absence of trustworthy alternative dispute resolutions will continue to plague investment and growth in Ukraine until resolved.

Market for Contract Law Reform

There is a large market for contract law reform in Ukraine. Practicing Ukrainian legal professionals and a large segment of academia recognize the need to modernize the existing contract law framework and to adopt a new, uniform, and modern contract law. There is a working group of professors and practitioners from Donetsk who have been engaged for several years in drafting a modern Civil Code, which is expected to address many of the needs of a modern system of contracts. However, drafts have not yet been made available to the general public for review or comment.

The Ukrainian legal community is divided between two proposals for the revised Civil Code:

1) adoption of a comprehensive Civil Code, which would include all provisions related to business entities and transactions, or
2) creation of a separate “Economic Code,” which would regulate exclusively the business entities and transactions.

Reforming economies in Central and Eastern Europe have adopted various approaches. Some of them recognized the need for specific regulation of business entities, and adopted separate trade laws or codes (Bulgaria, the Czech Republic). Others have adopted separate company laws and

[13] As reported by the Chairman of the Association of Commercial Arbitration Tribunals in Ukraine.

left the transaction regulations in the Civil Code.[14] Russia adopted a totally new Civil Code, which also governs business transactions.

Developments in Ukraine are being influenced by an influential group of old-line professors, who support strong state involvement in the economy rather than a market system. They have prepared a draft Economic Code that maintains many practices prevalent in centrally-planned economies, including the obligation of the enterprises to fulfill state orders pursuant to administrative decisions instead of contracts. Elsewhere in Europe the advocates of separate economic codes have been mostly guided by liberal ideas of limited state involvement and greater contractual freedom, but the same name is used in Ukraine for absolutely contrary purpose.

Another group of professionals, including practicing lawyers and members of the academia, advocates restricted state involvement and greater contractual freedom. This group has limited practical experience, because of their limited exposure to real commercial transactions. There is strong demand by this group, however, to apply the legislative and judicial practices of the developed market economies, and to adopt modern contract legislation in Ukraine. Comparative studies of the legislation adopted in other reforming economies in the last several years support this demand.

Despite the work being done on a draft Civil Code, Ukraine still lacks the open policy discussion needed to bring popular and professional support for market-friendly changes. If the anti-market professionals have their way, Ukraine may well adopt very conservative "economic code," which will continue to marginalize the legal systems as the surrounding region marches on to modern times. This cannot bode well for economic growth or development of Ukraine.

[14] This has been the case in Poland for instance. While Poland has a separate Commercial Code, it regulates primarily company formation. Business transactions are regulated by the Civil Code.

F. FOREIGN DIRECT INVESTMENT (FDI) LAW

As reflected in the summary table of Tier II indicators, Ukraine scored well below Poland and Romania in three of the four "dimensions" of the legal and institutional environment for foreign direct investment. As in other subject matter areas, Ukraine has a good framework law in place. As reflected by the indicator scores, however, the institutional framework and market for increased FDI are rather weak.

The indicator scores for Ukraine's FDI environment are generally supported by broad quantitative measures of economic performance. To date, for example, Ukraine has attracted approximately $2.2 billion of foreign direct investment, as compared to Romania and Poland, who have attracted $3.4 billion and $20 billion respectively. On a per capita basis, Ukraine ranks well behind its neighbors in FDI. On a regional basis, Ukraine has attracted approximately 10% of the FDI flows into the NIS region, and approximately 2.5% of the investment flows into the entire NIS/CEE region.[15]

Framework Law

Ukraine's leadership has frequently stated that it is eager to attract and retain significant levels of foreign direct investment. In 1996, Ukraine announced that it needed $40 billion of investment over five years in order to meet development needs. To date, Ukraine has fallen far short of that goal. Also during 1996, Ukraine adopted its Law on Foreign Investment,[16] and ratified a Bilateral Investment Treaty (BIT) with the United States.

As reflected in the Tier III indicator scores, Ukraine's FDI law substantially conforms with emerging international standards (e.g., the World Bank's "*Legal Framework for the Treatment of Foreign Investment*") for admission and treatment of FDI. Specifically, the Ukrainian law calls for open admission, national treatment (with some exceptions), repatriation of profits, and prompt and adequate compensation in the case of expropriation. Article 8 of the law contains a guarantee against substantive changes in the legislation that would diminish the guarantees extended under it. As discussed below, this guarantee is not viewed as particularly credible in light of the experience of many foreign investors. Overall, however, from the narrow perspective of the letter of the framework law, it is judged to be on par with those in force in Poland and Romania. One must remember however, that this is the fourth law on foreign investment in seven years, and it has already been amended several times.

Despite potentially positive developments in these aspects of the legal framework, registration of foreign investment has an overall negative impact. These burdensome requirements must be amended in line with more common international practices to realize Ukraine's potential for attracting outside investment.

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[15] Estimate based on EBRD, IMF, and OECD figures for the period 1989 - 1997.
[16] *Law on Foreign Investment*, #93/96, 3/19/96.

Implementing and Supporting Institutions

The primary implementing institution for the purposes of this analysis is the ministry, agency, department, or quasi-governmental organization with primary responsibility for promoting foreign direct investment. In Poland, this is the Polish Development Agency (PAIZ); in Romania, the Romanian Development Agency (RDA). In Ukraine, there is no clearly identifiable entity charged with this responsibility. Instead, this type of activity is dispersed among several ministries and quasi-governmental entities. Principal among these appear to be the Ministry of Economy, Department for Foreign Credit and Investment Coordination, the Ministry for Industrial Policy, Department for Export Promotion, and various line ministries with sectoral mandates (e.g., Agriculture, Energy, Transport). Those institutions do not have clear mandates, however, and often have overlapping responsibilities; and they are not perceived by the investment public as competent and investment friendly agencies. Their development agenda is often inconsistent with sound economic practices and this results in disputes between them and the investors.

There is no major organization representing the foreign investors in general. The creation of the Foreign Investment Advisory Council (FIAC) in 1997 was viewed as positive development at the time. FIAC provides advice to the President, but this is not a permanent working body and foreign investors are cautiously optimistic as to the ability of FIAC to produce constructive results. The American Chamber of Commerce in Ukraine seems to be the focal point for discussions and development of policy proposals. It has identified several major problem areas and developed proposals for improvement, but with limited success so far. In cooperation with the Chamber several private law firms and securities companies are maintaining active promotion efforts, directed at potential foreign clients primarily in the capital markets.[17] There is an active research services sector, targeting the companies potentially interested in the securities market, but at present the activities there are restricted mostly to analytical work in the expectation of improvement of the overall investment climate. A Chamber of Independent Experts is active under the auspices of the President of Ukraine, but this institution is designed more to provide "damage control" and alternative dispute resolution capacity. The experience of the Chamber could be useful if summarized at certain intervals and used in the improvement of the applicable regulations and administrative practices, but this has not occurred to date.

Investment promotion is, at best, underdeveloped. The few agencies given the task of promoting foreign participation seem more focused on preventing foreign investors from gaining unfair advantages over their local competitors than on attracting newcomers to viable investment projects. Government agencies do little to promote or identify opportunities, concentrating their resources instead on licensing and control functions, with the emphasis on control. Even in privatization, foreign investment participation is negligible, given the size of the Ukrainian industrial sector.

Not only is there a lack of a viable promotion agency (either public or private), but in some cases the Government has postured itself as a watchdog that must protect the country from outsiders

[17] Frishberg & Partners, The Ukrainian Legal Group, Baker & Mackenzie, and Altheimer & Gray are among the firms publishing regular newsletters or analyses of the latest legal developments.

with capital. There is a perception, at least in one of the ministries in charge, that the aim of major foreign investors is to restrict the ability of local enterprises to compete in certain industrial sectors. In the opinion of the Ministry of Industrial Policy, foreigners have "targeted" the cement and iron metallurgy industries, and some of the machine producing plants. Those who are mistrustful of foreign investment do not note that most of the competing products in those sectors (excluding metallurgy), are entering Ukraine from the neighboring countries, where they have been revitalized with foreign capital and marketing expertise. Ukrainian enterprises suffer not so much from cheap competition, but from their own inability to improve their own production.

To improve the picture, the Government will need to reconsider its role. The planning committee model currently in place, whose function is to control economic activity, will need to give way to an attitude of promotion. Technical assistance could be particularly useful in several areas:

- review and reform of administrative barriers to entry,
- identification and marketing of suitable investment projects,
- cooperation with the private sector in the improvement of existing infrastructure,
- initiation of policy dialogue between the investment community and the government,
- assistance to the local private sector in the identification of potential foreign partners, and
- development of services for potential investors.

Such activities are restricted by the lack of funds and experience, but most of all by the lack of a clear vision of the proper role of government in a market economy.
The approach of the Government with respect to foreign investment reflects the fact that most of the decision makers have never had the opportunity to run a private business, and therefore have little or no experience with the problems faced by private entrepreneurs. Supporting institutions can provide assistance to decision makers, but they will have to be encouraged and permitted to function in that manner.

Market for Reform

The need for reform in Ukraine is substantial, but not all of it is within the framework law. Most importantly, foreign investment is simply not respected by the Ukrainian Government—whether in the form of contracts, incentives, or the investors themselves. Practices that would be illegal anywhere in the European Union are regularly employed in attempting to extract better terms from investors after deals have been concluded, or to reframe the income and economics of the investment based on political decisions or improper influence. Foreign investment in the Ukraine is popularly seen as a nightmare, and a number of substantial investors have pulled out because of the problems outside of the framework law. How many others have decided to forego investment is inestimable.

On the surface, things should be better. In 1996-97, the Government concentrated on measures designed to improve the investment climate and alleviate the consequences of some unpopular decisions taken earlier. During this period, however, there has been a seemingly steady drumbeat of investment disputes between Ukrainian and foreign investors. For instance, preferential treatment of particular groups of local customers and arbitrary price formation were among the main reasons for disputes between foreign investors and the local authorities. One principal reason for disputes from those hardy investors who have stayed has been the treatment of investment incentives, provided by the government at an initial stages of investment and withdrawn at a later stage. Most recently the Government issued a decree requiring a number of enterprises with foreign participation to stop their "foreign economic activity," pending a decision by the Constitutional Court as to the constitutionality of some tax incentives given to those companies at the time of the initial investment.

Demand for change, ideally, should come from those who are losing potential foreign partners and foreign capital, government entities responsible for pursuing economic development, and the foreign investors themselves. Unfortunately, there appears to be no data collection or analysis being done by or for the Government to determine the impact of their policies and decisions. Foreign investors are not respected by the Government, so that they have very limited input into policy change. Perhaps popular sentiment will eventually create pressure for change as those who are truly losing ground—the general Ukranian population—become aware of the cost of the current situation.

A burdensome certification process may destroy successful potential ventures. After being granted a one–year temporary certificate to operate telecommunication equipment in the country, the US partner in a joint venture was dismayed to learn that the temporary certificate was revoked before the term of the certificate expired. The revocation was perceived as answer not to inferior technical standards, but to problems existing between the local partner and the US company. This misuse of regulatory authority resulted in problems that jeopardized the entire joint venture.

Foreign sovereigns may also provide some demand for change in an attempt to protect their nationals whose assets have been confiscated or investments suborned. This is certainly necessary, but not sufficient to achieve the level of change needed.

The supply of foreign investment law needs to be designed to improve the overall investment climate, not just the climate for outside capital or mega-investors. There seems to be little appreciation for the fact that foreign investors can operate successfully only if the investment climate is friendly for the local investors as well. Several major issues, particularly in the area of property regulations and stable taxation rules and procedures, should be considered as critical for the improvement of the investment climate in general.

Changes in supply should include replacing investment planning with investment promotion; adoption of clear and transparent investment regulations; and reduction of the cost and complexity of registration and licensing requirements. Predictability of all actions in an investment operation should be a priority for all investment regulations developed by the government.

Finally, the government should seek more active support from the international financial institutions and the broader business community for the development of the regulatory framework. A law, developed with international assistance, is often perceived as more stable because of the consideration given to the opinion of all interested parties.

For help on both supply and demand, the government should encourage the formation of lobby and policy formulation groups, which capture and express the opinion of the investment community on the proposed legislative measures and are in position to identify the existing problems and propose practical solutions for them. The government should be more active in obtaining the opinions of self-regulatory professional associations. They are particularly well qualified to identify technical problems in issues of direct concern to them and to foreign investors. The government does not perceive such problems as directly related to foreign investment, but investment decisions are often adversely affected by unclear technical regulations. Many countries , which were successful in attracting substantial foreign investment, conduct annual reviews of their certification procedures, in order to ensure that technical problems do not represent hidden impediments to investors. The adoption of such practices would certainly be beneficial for Ukraine.

F. TRADE

The legal and institutional regimes governing international trade are as a general matter broad, complex, and dynamic. By design, many aspects of trade regimes are responsive to changing economic, and non-economic factors. The diagnostic indicators for trade, and this narrative summary, are not intended to provide a comprehensive or authoritative description of Ukraine's current trade regime. Instead, an effort was made to develop a methodology for taking a "snapshot" of current conditions—without any detailed analysis of trends or nuances of the complex forces that are at play in the development of this important area of commercial law.

As summarized in the general indicator table at the beginning of this report, Ukraine has a population of 50.5 million, with a GDP per capita of $3,170. With a shadow economy estimated between 40% and 60% of GDP, Ukraine's economy is considerably larger than official statistics suggest. Ukraine is also blessed—or cursed—by that fact that Soviet industrial development was extensive in the western portion of the country. With a rich agricultural endowment, large territory, developed (albeit rundown) infrastructure networks, and a well-educated population, one would think Ukraine is well positioned to benefit significantly from the economic growth that comes with trade liberalization.

Ukraine's foreign trade is predominantly with NIS countries (61%), followed by the European Union (EU) (15%), and the U.S. (6%). Ukraine has signed a Free Trade Agreement with Russia and, as mentioned in the pervious section, various trade and investment treaties with the U.S. Trade turnover for 1998 was approximately $26.5 billion, with a net trade deficit of slightly less than $2 billion.

Legal Framework

Trade relations between Ukraine and the EU are governed by a Partnership and Cooperation Agreement (PCA) signed in June 1994 that replaced the earlier trade and cooperation agreement signed in 1989 between the EC and the Soviet Union. The PCA entered into force on March 1, 1998.

The PCA defines the legal parameters for trade between Ukraine and the EU, and specifies trade concessions such as most-favored-nation (MFN) status and access to the Generalized System of Preferences (GSP). Measures for phased liberalization of trade in services, FDI, capital transfers, and protection of intellectual property rights are also addressed. The PCA also creates a framework for on-going cooperation, primarily in the form of an annual Ministerial Cooperation Council, and a Parliamentary Cooperation Committee.

Trade relations between the U.S. and Ukraine are governed by the U.S.-Ukraine Trade Agreement, signed May 6, 1992, and approved by a resolution from the Cabinet of Ministers later that year. Under this agreement, the parties extend mutual Most Favored Nation (MFN) status.

In addition, mutual consultations on trade and other relevant topics occur under the Gore-Kuchma consultative mechanism.

At present, Ukraine is in the process of joining the World Trade Organization (WTO), and Ukraine's Working Party was established on December 17, 1994. Initial offers on tariffs were tabled at the third Working Party meeting held in late June 1996. To date, little progress has been made in negotiations on Ukraine's offers. The seventh and most recent Working Party meeting was held in June 1998. According to a source close to the process, Ukraine's progress in responding to numerous questions posed during these meetings has been rather disappointing. Numerous sticking points in these negotiations remain. Areas of particular concern include agriculture, the customs system, excise and value added taxes, import licensing and other non-tariff measures, industrial subsidies, national treatment, services, state trading, transparency and legal reform, and trade related intellectual property issues.

Ukraine's current tax and import duty regimes are highly complex, burdensome, and frequently discriminatory in application to foreign products. Product categories where non-tariff barriers are quite high include alcohol, tobacco, automobiles, and various luxury items. A lack of a transparent and consistently applied legal and procedural framework for government procurement is yet another area where Ukraine is well below minimum internationally accepted standards.

Ukraine's customs valuation rules substantially conform with world standards, where customs value is defined as the sum of the sales price, transportation costs, freight, insurance, storage fees, and any other costs not foreseen in the contract price. Receipts should be presented to document these costs and to allow customs officers to determine the proper customs value. In the event that receipts are not available, Ukrainian customs will assess the customs value using comparative pricing of similar goods and services in the country of origin.

One area of relative progress on this otherwise bleak landscape is in the area of intellectual property rights. While much work has to be done, framework laws protecting patent, copyright, trademarks, and other forms of intellectual property are in place. The implementation/ enforcement gap" in this area remains sizeable, and enforcement seems to be *de minimis* based on an unscientific sampling of kiosks in the pedestrian underpasses of Kiev.

Implementing Institutions

For the purpose of this assessment, Ukraine's implementing institution for trade is the Ministry of Foreign Economic Relations and Trade. The assessment of its institutional capacity is based on an admittedly narrow sample of meetings with relevant government officials, donor-funded advisors, and private sector participants. It is clear, however, based on the responses received, that Ukraine's capacity to formulate and execute a coherent trade policy in conformity with internationally accepted norms is quite low. Perhaps the best evidence of this basic lack of capacity is found in Ukraine's inability or unwillingness to provide detailed, accurate responses to WTO Working Party questions. The Ukrainian delegation's performance during the most recent meetings held in Geneva has been described by one knowledgeable observer as extremely disappointing.

Ukraine's regulatory environment for trade is Byzantine and, in application, quite protectionist. The area that has attracted the most attention—and protest—is the area of technical barriers to trade, most notably certification and licensing. Therefore Ukraine's standards body—*Derstandard*, is included in this analysis. It should be noted that *Derstandard* declined the opportunity to meet with the assessment team to clarify its position on several key issues. As a consequence, the assessment team adopted the well known standard of "*best information available*" in completing the relevant indicator tables. In this case, the anecdotal evidence of *Derstandard*'s abuses is copious. Recently, for example, a major international consumer goods company was forced to pull globally recognized brands of detergents and shampoo from the shelves of 25,000 stores across Ukraine because it refused to underwrite "inspections" by *Derstandard* officials of foreign production facilities it maintains in Europe, North America and elsewhere. Other large multinational consumer products companies have been subject to similar demands and threatened with similar sanctions. Telecommunications companies have also been subject to *Derstandard*'s attentions.

Supporting Institution

The Customs Service of Ukraine (CSU)was established in December 1991, and consists of 70 approved customs clearing points and 222 customs posts along 8,215 km of sea and land borders. The CSU is reported to have a staff training center, a canine detection unit, and a computer center, although this was not independently verified by the assessment team. The latest available data puts CSU staff levels at approximately 13,000.

Enforcement of Ukraine's customs and other applicable regulations by CSU is notoriously unpredictable. Importers are required to complete a customs freight declaration for every item imported. Frequently changing regulations and idiosyncratic interpretations of them,makes clearing even the simplest shipment through customs a potential lengthy and expensive proposition. The problem of customs enforcement has become such a problem that trade volume through Ukraine's southern ports is being diverted in significant volumes to Romanian and Russian ports.

CSU is considered to be an exceptionally difficult organization to work with, even by regional standards. As reflected in the associated indicator scores, the supporting institutional framework for trade is judged to be generally ineffective in terms of transparency and consistency in enforcing regulatory requirements. A general consensus existed among those interviewed (outside of official government circles) that, along with Derstandard, CSU was among the most unpredictable state regulatory bodies in the trade sphere.

The "Market" for Trade Liberalization

The market for trade liberalization is quite weak in Ukraine. The slow progress Ukraine has made in meeting the requirements of WTO membership is just one indication of a lack of clear policy priority. The relative oversupply of non-WTO compliant regulatory measures, the weak institutional structures, and the general lack of transparency and consistency in applying internationally recognized norm all point to a significant mismatch between word and deed in this area. On the demand side, the strongest and most consistent advocates for reform are foreign trading partners and their nationals doing business in Ukraine. General perceptions and attitudes remain surprisingly ambivalent to the potential benefits of foreign trade and a degree of xenophobia seems to be a part of this phenomenon. Unlike Poland, and to a somewhat lesser extent in Romania, the "gravitational pull" of prospective WTO and EU membership seems diffuse by comparison in Ukraine. It therefore seems unlikely that significant trade liberalization and associated institutional strengthening can be expected. Unfortunately for most Ukrainian's this is likely to mean that the prospects of an improved living standard in the near term are also diminished.

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